

Decision **DRAFT DECISION OF ALJ DUDA** (Mailed 8/5/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application and Request for Expedited Ex Parte Treatment of KDD America, Inc. and DDI Corporation for Approval of Transfer of Control.

Application 00-09-064
(Filed September 27, 2000)

**OPINION GRANTING INDIRECT TRANSFER OF CONTROL
AND FINING APPLICANTS FOR VIOLATION OF SECTION 854(a)
OF THE PUBLIC UTILITIES CODE**

1. Summary

DDI Corporation (DDI) and KDD America, Inc. (KDDA) (collectively Applicants) request approval of a transaction wherein DDI will acquire indirect control of KDDA through acquisition of KDDA's parent company, KDD Corporation (KDD). This decision grants Application (A.) 00-09-064 to the extent it requests prospective authority under Pub. Util. Code § 851 through 854¹ for the indirect transfer of control. This decision denies A.00-09-064 to the extent it requests retroactive authority for the acquisition. Finally, this decision requires Applicants to pay a fine of \$5,000 for their failure to obtain Commission authorization for this transfer of control prior to consummating the transaction as required by § 854(a).

¹ All statutory references are to the Pub. Util. Code unless otherwise indicated.

2. Background

KDDA is a New York Corporation authorized to do business in California. In Decision (D.) 98-05-001 the Commission granted KDDA a certificate of public convenience and necessity (CPCN) to provide resold and facilities-based interexchange telecommunications services within California. KDDA also provides long distance services in various other states and provides international telecommunications services under authority granted by the Federal Communication's Commission (FCC). KDDA is a wholly owned subsidiary of KDD, a Japanese Corporation.

DDI is a Japanese corporation providing primarily domestic long distance service in Japan. In addition, DDI provides international telephone services and cellular services through various subsidiaries. DDI does not currently have authorization to provide intrastate service in California.²

² Rule 16(a) requires an applicant that is not a domestic corporation to include with its application a copy of its certificate of qualification to transact intrastate business certified by the California Secretary of State. Although DDI is not a domestic corporation, it did not provide the certificate of qualification to transact intrastate business with its application. Applicants request a waiver of Rule 16(a) on the grounds that DDI is a holding company organized under the laws of Japan that does not directly provide any services in California. According to the motion, DDI's California operations are conducted exclusively by its subsidiary KDDA, which is qualified to transact business in the state. As part of the motion for a waiver, Applicants attached a declaration stating that DDI will not challenge the Commission's jurisdiction over it on the grounds that it is not qualified to conduct business in California. Applicants state that if DDI does, at some time in the future, transact business in the state, it will obtain all necessary qualifications. We will grant the requested waiver of Rule 16(a) given the unique circumstances of this application and Applicants' accompanying declaration.

3. Requested Authority

The proposed transfer of control is part of a three-way merger among DDI, KDD, and IDO Corporation (IDO).³ On April 5, 2000, KDD, DDI, and IDO executed a Merger Agreement that would result in DDI owning all of the issued and outstanding stock of KDD, which in turn will own all of the issued and outstanding stock of KDDA. The agreement would also result in DDI owning all of the issued and outstanding stock of IDO.

On September 27, 2000, KDDA and DDI jointly filed A.00-09-064 for authority under §§ 851 through 854 for DDI to acquire KDDA. The application stated Applicants' intent to complete the proposed transfer of control and consummate the merger four days later, on October 1, 2000. Accordingly, Applicants requested that the approval of the merger be made effective retroactively, or nunc pro tunc,⁴ as of October 1, 2000. Applicants explained that they had made efforts to obtain all necessary U.S. regulatory approvals to permit consummation by October 1, 2000 but discovered only recently that they inadvertently had not applied for Commission approval.

Applicants state that although the transaction will result in a change of the ultimate corporate parent of KDDA, it will not result in a change in the California operations of KDDA nor will it affect the manner in which KDDA provides services to its California customers. Applicants state that KDDA will

³ IDO is a Japanese corporation providing cellular service in Japan and is not a party to this application.

⁴ The phrase "nunc pro tunc," meaning "now for then," refers to those acts which are allowed to be done at a later time "with the same effect as if regularly done." (Blacks Law Dictionary (4th Revised ed. (1968), p. 1218)).

not make any changes in the terms or conditions of service as a result of the transaction, and it will continue to be led by the same management team. They further claim that the transaction wherein KDDA will become an indirect wholly owned subsidiary of DDI will be virtually transparent to California customers.

Applicants claim that the proposed merger will serve the public interest in promoting competition in the United States by permitting KDDA and DDI to compete more effectively by combining their financial resources and complementary services, facilities, and expertise. Specifically, Applicants claim the merger will permit KDDA and DDI to realize significant economic, marketing, and technical efficiencies and enhance KDDA's ability to provide high quality, low-cost competitive telecommunications services.

Notice of A.00-09-064 appeared in the Commission's Daily Calendar on October 11, 2000. There were no protests or responses to the application.

4. Amended Application

On November 30, 2000, the assigned Administrative Law Judge issued a ruling requiring Applicants to file an amended application indicating whether the proposed transfer of control had indeed been completed. If the transaction had been completed, Applicants were directed to explain why the transfer of control should not be declared void and of no effect for failure to comply with the pre-approval requirements of § 854. Applicants were also asked how they might "unwind" the transaction if it were declared null and void by the Commission, and what level of monetary penalty might be appropriate should the Commission find that Applicants had violated § 854.

Applicants responded to this ruling on December 21, 2000 and stated that the merger had been consummated on October 1, 2000. Applicants explain that because the transaction merged two Japanese multinational holding companies,

the transaction was negotiated and coordinated largely by representatives in Japan. While these representatives did obtain all necessary FCC approvals, they were less familiar with specific state requirements and inadvertently failed to comply with § 854. They state that the application was filed promptly upon KDDA's recognition that California approval was required, but that the multinational nature of the merger made it impossible to delay the scheduled closing of the transaction while awaiting Commission approval.

Applicants argue that the Commission should not declare the merger void because KDDA's California customers typically purchase international and interstate services from the company, and any intrastate usage is merely incidental. Applicants note the Commission has jurisdiction over only the intrastate services provided by KDDA and claim that it would be technically infeasible, if not impossible to separate KDDA's intrastate operations from its interstate and international ones. They state the California portion of the transaction cannot be unwound without interfering with the interstate and international elements of the combined companies' operations. If such a separation was required, Applicants state that KDDA would cease providing intrastate services to California customers which would likely cause rate increase and service disruptions for KDDA's California customers. Furthermore, they argue that such a result is not in the public interest because it would inconvenience California customers and not allow them to obtain their intrastate, interstate, and international services from a single carrier. Because the necessary FCC approvals were obtained prior to closing the merger, Applicants suggest that the Commission can be assured the merger is in the public interest.

Finally, Applicants respond that the Commission should impose the minimum fine authorized by law for Applicants' violation of § 854 because it was

unintentional and has not resulted in any unlawful economic benefits to KDD or DDI.

5. Discussion

a. Whether to Approve the Application

In A.00-09-064, the Applicants request authority under §§ 851 through 854 for DDI to indirectly acquire KDDA through merger with its parent, KDD.

Section 854(a) states, in relevant part, as follows:

No person or corporation...shall merge, acquire, or control...any public utility organized and doing business in this state without first securing authorization to do so from the commission...Any merger, acquisition, or control without that prior authorization shall be void and of no effect.

The Commission has broad discretion to determine if it is in the public interest to authorize a transaction pursuant to § 854(a).⁵ The primary standard used by the Commission to determine if a transaction should be authorized under § 854(a) is whether the transaction will adversely affect the public interest.⁶ The Commission may also consider if the transaction will serve the public interest.⁷ Where necessary and appropriate, the Commission may attach conditions to a transaction in order to protect and promote the public interest.⁸

⁵ D.95-10-045, 1995 Cal. PUC LEXIS 901, *18-19; and D.91-05-026, 40 CPUC2d 159, 171.

⁶ D.00-06-079, p. 13; D.00-06-057, p. 7; D.00-05-047, p. 11 and Conclusion of Law (COL) 2; D.00-05-023, p. 18; D.99-03-019, p. 14; D.98-08-068, p. 22; D.98-05-022, p. 17; D.97-07-060, 73 CPUC2d 601, 609; D.70829, 65 CPUC 637, 637; and D.65634, 61 CPUC 160, 161.

⁷ D.00-06-005, 2000 Cal. PUC LEXIS 281, *4; D.99-04-066, p.5; D.99-02-036, p. 9; D.97-06-066, 72 CPUC2d 851, 861; D.95-10-045, 62 CPUC2d 160, 167; D.94-01-041, 53

Footnote continued on next page

For the following reasons, we conclude that it is reasonable to grant A.00-09-064 to the extent the application requests prospective authority under § 854(a) for DDI to acquire control of KDDA. First, there will be no change to terms or conditions of service for KDDA customers as a result of the transaction. Thus, KDDA's customers and the public will not be harmed by the acquisition of KDDA's parent company, KDD. Second, DDI, as an international provider of telecommunications services, has the technical, managerial, and financial qualifications necessary to exercise control over KDDA. Third, the public may benefit from the transfer of control to the extent the transaction enhances KDDA's ability to compete through lower rates and/or new or improved services. Fourth, there is no opposition to this application. For these reasons, we see no reason to withhold authority for the indirect transfer of control before us here.

We deny A.00-09-064 to the extent the application requests retroactive authority under § 854(a) for DDI to control KDDA. The purpose of § 854(a) is to enable the Commission to review a proposed acquisition, *before it takes place*, in order to take such action as the public interest may require.⁹ Granting this application on a retroactive basis would thwart the purpose of § 854(a). Since we

CPUC2d 116, 119; D.93-04-019, 48 CPUC2d 601, 603; D.86-03-090, 1986 Cal. PUC LEXIS 198 *28 and COL 3; and D.8491, 19 CRC 199, 200.

⁸ D.95-10-045, 62 CPUC2d 160, 167-68; D.94-01-041, 53 CPUC2d 116, 119; D.90-07-030, 1990 Cal. PUC LEXIS 612 *5; D.89-07-016, 32 CPUC2d 233, 242; D.86-03-090, 1986 Cal. PUC LEXIS 198 *84-85 and COL 16; and D.3320, 10 CRC 56, 63.

⁹ D.99-02-061, 1999 Cal. PUC LEXIS 56 *12; D.98-07-015, 1998 Cal. PUC LEXIS 526 *7; D.98-02-005, 1998 Cal. PUC LEXIS 320 *8; D.97-12-086, 1997 Cal. PUC LEXIS 1168 *8; and San Jose Water Co. (1916) 10 CRC 56, 63.

do not grant retroactive authority, DDI's acquisition of control over KDDA is void under § 854(a) for the period of time prior to the effective date of this decision. The Applicants are at risk for any adverse consequences that may result from their having effected the acquisition without Commission authority.

We will not require applicants to unwind the merger because we do not find it to be in the public interest to force KDDA to separate its intrastate operations from its other operations, particularly if such a separation only causes KDDA to cease serving customers in California. The net result would be an inconvenience for customers that we prefer to avoid.

b. Whether to Penalize the Applicants for Their Failure to Comply with Pub. Util. Code § 854(a)

Applicants failed to comply with § 854(a) by DDI acquiring control of KDDA without Commission authorization. Violations of § 854(a) are subject to monetary penalties under § 2107 which states as follows:

Any public utility which violates or fails to comply with any provision of the Constitution of this state or of this part, or which fails or neglects to comply with any part or provision of any order, decision, decree, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to a penalty of not less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense.

For the following reasons, we conclude that the Applicants should be fined for their failure to comply with § 854(a). First, any violation of § 854(a), regardless of the circumstances, is a serious offense that should be subject to fines. Second, the imposition of a fine will help to deter future violations of § 854(a) by the Applicants and others.

To determine the size of the fine, we shall rely on the criteria adopted by the Commission in D.98-12-075. We address these criteria below.

Criterion 1: Severity of the Offense

In D.98-12-075, the Commission held that the size of a fine should be proportionate to the severity of the offense. To determine the severity of the offense, the Commission stated that it would consider the following factors:¹⁰

Physical harm: The most severe violations are those that cause physical harm to people or property, with violations that threatened such harm closely following.

Economic harm: The severity of a violation increases with (i) the level of costs imposed upon the victims of the violation, and (ii) the unlawful benefits gained by the public utility. Generally, the greater of these two amounts will be used in setting the fine. The fact that economic harm may be hard to quantify does not diminish the severity of the offense or the need for sanctions.

Harm to the Regulatory Process: A high level of severity will be accorded to violations of statutory or Commission directives, including violations of reporting or compliance requirements.

The number and scope of the violations: A single violation is less severe than multiple offenses. A widespread violation that affects a large number of consumers is a more severe offense than one that is limited in scope.

Applicants' violation of § 854(a), while serious, was not an especially egregious offense. This is because the violation did not cause any physical or economic harm to others. In addition, there is no evidence that the Applicants

¹⁰ 1998 Cal. PUC LEXIS 1016, *71 - *73.

significantly benefited from their unlawful conduct. Furthermore, the violation of § 854(a) affected few, if any, consumers. The only factor that indicates the violation should be considered a grave offense is our general policy of according a high level of severity to any violation of the Pub. Util. Code. However, this factor must be weighed against the other factors indicating that Applicants' failure to comply with § 854(a) was not an especially egregious offense.

Criterion 2: Conduct of the Utility

In D.98-12-075, the Commission held that the size of a fine should reflect the conduct of the utility. When assessing the conduct of the utility, the Commission stated that it would consider the following factors:¹¹

The Utility's Actions to Prevent a Violation: Utilities are expected to take reasonable steps to ensure compliance with applicable laws and regulations. The utility's past record of compliance may be considered in assessing any penalty.

The Utility's Actions to Detect a Violation: Utilities are expected to diligently monitor their activities. Deliberate, as opposed to inadvertent wrongdoing, will be considered an aggravating factor. The level and extent of management's involvement in, or tolerance of, the offense will be considered in determining the amount of any penalty.

The Utility's Actions to Disclose and Rectify a Violation: Utilities are expected to promptly bring a violation to the Commission's attention. What constitutes "prompt" will depend on circumstances. Steps taken by a utility to promptly and cooperatively report and correct violations may be considered in assessing any penalty.

¹¹ 1998 Cal. PUC LEXIS 1016, *73 - *75.

Applicants claim they made good faith efforts to comply with California law and that their failure to file a timely application with the Commission was an unfortunate oversight. Nevertheless, Applicants deliberately proceeded to close the merger only days after the filing in California even with the realization that this action would violate § 854. Although Applicants detected the impending violation and disclosed it, they did not prevent it. Further, they took no action to correct it. This suggests a larger fine is appropriate since Applicants violated § 854 even though they detected the situation in time to prevent it.

Criterion 3: Financial Resources of the Utility

In D.98-12-075, the Commission held that the size of a fine should reflect the financial resources of the utility. When assessing the financial resources of the utility, the Commission stated that it would consider the following factors:¹²

Need for Deterrence: Fines should be set at a level that deters future violations. Effective deterrence requires that the Commission recognize the financial resources of the utility in setting a fine.

Constitutional limitations on excessive fines: The Commission will adjust the size of fines to achieve the objective of deterrence, without becoming excessive, based on each utility's financial resources.

DDI is a large multinational company with total revenues as of March 31, 1999 of \$10.3 billion, and net income for the same period of \$142 million.¹³ KDD, the parent company of KDDA, is also a large multinational with total revenues

¹² 1998 Cal. PUC LEXIS 1016, *75 - *76.

¹³ See A.00-09-064, Exhibit 3, DDI 1999 Annual Report, p. 29.

for the year ended March 31, 1999 of \$3.3 billion and a net loss of \$15.9 million.¹⁴ The financial records of KDDA indicate it had total revenues for 1999 of \$73 million and a net loss of \$6 million.¹⁵ KDDA reported to the Commission that for the year 2000, it had intrastate revenues of approximately \$110,000.¹⁶ From this information we conclude that while Applicants' California operations and revenues may be minimal, the parent companies involved with this indirect transfer of control have substantial financial resources to pay a fine for their violation of § 854(a). We will weigh these factors accordingly when setting the amount of the fine.

Criterion 4: Totality of the Circumstances

In D.98-12-075, the Commission held that a fine should be tailored to the unique facts of each case. When assessing the unique facts of each case, the Commission stated that it would consider the following factors:¹⁷

The degree of wrongdoing: The Commission will review facts that tend to mitigate the degree of wrongdoing as well as facts that exacerbate the wrongdoing.

The public interest: In all cases, the harm will be evaluated from the perspective of the public interest.

The facts of this case indicate that the degree of wrongdoing, though serious, was not egregious. Applicants' conduct was serious because even after uncovering the potential violation, Applicants proceeded to violate § 854. While

¹⁴ *Id.*, Exhibit 1, KDD 1999 Annual Report, p. 1.

¹⁵ *See* Applicants' Motion for Waiver of Rule 16(a), 3/20/01, Exhibit B.

¹⁶ *Id.*, Exhibit C.

¹⁷ 1998 Cal. PUC LEXIS 1016, *76.

the delay in filing for approval in California may have been unintentional, the ultimate violation was done with full knowledge. However, no one was harmed by Applicants' failure to comply with § 854(a) and Applicants do not appear to have materially benefited from their unlawful conduct. These facts indicate that the public interest was not significantly harmed by Applicants' violation of § 854(a). We will balance the higher degree of wrongdoing against the relatively small harm to the public interest from this violation.

Criterion 5: The Role of Precedent

In D.98-12-075, the Commission held that any decision which imposes a fine should (1) address previous decisions that involve reasonably comparable factual circumstances, and (2) explain any substantial differences in outcome.¹⁸

The facts of this case are generally comparable to many Commission decisions that approved, without penalty, transactions that were effected without prior Commission authorization in violation of § 854(a).¹⁹ However, in D.00-09-035 we held that our precedent of meting our lenient treatment to those who violate § 854(a) had failed to deter additional violations; and we indicated that henceforth we would impose fines in order to deter future violations of § 854(a). In both D.00-12-053 and D.03-05-033, the Commission fined telecommunications carriers \$5,000 for similar violations of §854(a). Therefore, it

¹⁸ 1998 Cal. PUC LEXIS 1016, *77.

¹⁹ The following Commission decisions approved, without penalty, transactions that had been consummated without Commission authorization in violation of § 854(a): D.00-09-033, D.00-04-014, D.99-12-039, D.99-11-010, D.99-10-007, D.99-06-016, D.99-03-030, D.97-12-072, D.97-09-097, D.96-05-067, D.95-07-051, D.95-05-009, D.94-12-062, D.94-05-030, D.93-07-009, D.89-06-024, D.89-02-004, D.87-03-048, D.86-02-005, D.85-10-017, D.84-07-077, D.84-06-087, D.83-05-018, and D.93673.

would be consistent with those two prior decisions to impose the same size fine in this case because the violation is virtually identical.

Conclusion: Setting the Fine

We conclude based on the facts of this case that the Applicants should be fined \$5,000 for violating § 854(a). The fine we impose today is meant to deter future violations § 854(a) by the Applicants and other parties. We emphasize that the size of the fine we impose today is tailored to the unique facts and circumstances before us in this proceeding. We may impose larger or smaller fines in other proceedings if the facts so warrant.

6. Category and Need for Hearing

In Resolution ALJ 176-3049, dated October 19, 2000, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were not necessary. Based on the record, we affirm that this is a ratesetting proceeding, and that hearings are not necessary.

7. Comments on Draft Decision

The Commission mailed the draft decision of the Administrative Law Judge (ALJ) in this matter to the parties in accordance with § 311(g)(2) and Rule 77.7 of the Rules of Practice and Procedure. Applicants agreed to a shortened seven-day comment period as allowed by Rule 77.7(g). There were no comments filed.

8. Assignment of Proceeding

Carl Wood is the Assigned Commissioner and Dorothy Duda is the assigned ALJ in this proceeding.

Findings of Fact

1. KDDA is a New York corporation authorized to do business in California. KDDA was granted a CPCN in D.98-05-001 to provide interexchange telecommunications services within California.

2. DDI is a Japanese corporation that does not have authorization to provide telecommunications services in California.

3. KDDA is a wholly owned subsidiary of KDD, a Japanese Corporation.

4. On September 27, 2000, KDDA and DDI jointly filed A.00-09-064 for authority for DDI to acquire indirect control of KDDA through its acquisition of KDD.

5. The indirect transfer of control of KDDA to DDI was completed without Commission authorization on October 1, 2000 prior to Commission approval of A.00-09-045.

6. Pub. Util. Code § 854(a) requires Commission authorization to transfer control of a public utility. Any transfer of control without Commission authorization is void under the statute.

7. DDI has the technical, managerial, and financial qualifications necessary to operate KDDA.

8. Applicants state that there will be will be no changes in the terms or conditions of service or management of KDDA as a result of the acquisition of KDDA's parent company by DDI.

9. There were no protests to A.00-09-064.

10. Pub. Util. Code § 2107 provides the Commission with authority to impose a penalty of between \$500 and \$20,000 for violations of the Pub. Util. Code.

11. In D.98-12-075, the Commission adopted the following criteria for determining the amount of a fine: (i) the severity of the offense, (ii) the conduct

of the utility, (iii) the financial resources of the utility, (iv) the totality of the circumstances, and (v) the role of precedent.

12. Applicants failure to comply with § 854(a) harmed the regulatory process but did not harm others and did not significantly benefit the Applicants.

13. Applicants proceeded to close the merger of KDD and DDI even though they were aware this would violate § 854.

14. Applicants have significant financial resources, but minimal intrastate operations and revenues.

15. Applicants request a waiver of Rule 16(a) to the extent it requires a non-domestic corporation to provide a copy of its certificate of qualification to transact intrastate business.

Conclusions of Law

1. This is a ratesetting proceeding and no hearing is necessary.

2. A.00-09-064 should be approved on a prospective basis because it is not adverse to the public interest.

3. Applicants violated § 854(a) by transferring indirect control of KDDA to DDI without Commission authorization. Applicants' violation of § 854(a) is subject to monetary penalties under § 2107.

4. Applicants' should be fined for violating § 854(a). The amount of the fine should be based on the criteria set forth in D.98-12-075.

5. Applicants' violation of § 854(a), though a serious matter, was not an especially egregious offense.

6. The public interest was not significantly harmed by Applicants' violation of § 854(a).

7. The application of the criteria in D.98-12-075 to the facts of this case indicates that Applicants should pay a fine of \$5,000 for violating § 854(a).

8. It is necessary to fine Applicants for violating § 854(a) in order to deter future violations of § 854(a) by Applicants and others.
9. The Commission should waive Rule 16(a) for this application.
10. The following order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Application (A.) 00-09-064 for authority under Pub. Util. Code § 851 through 854 to transfer control of KDD America, Inc. (KDDA) to DDI Corporation (DDI) (collectively Applicants) is granted to the extent A.00-09-064 requests authority effective as of the date of this order. A.00-09-064 is denied to the extent that it requests retroactive authority for DDI to obtain control of KDDA.
2. KDDA and DDI shall notify the Director of the Commission's Telecommunications Division in writing of the transfer of control, as authorized herein, within 10 days of this order. A true copy of the instrument(s) of transfer shall be attached to the notification.
3. Applicants shall pay a fine in the amount of \$5,000 for violating Pub. Util. Code § 854(a). Applicants shall pay the fine within 20 days from the effective date of this order by tendering to the Fiscal Office of the California Public Utilities Commission a check in the amount of \$5,000 made payable to the State of California General Fund.
4. Applicants' motion to waive Rule 16(a) is granted.
5. A.00-09-064 is closed.

This order is effective today.

Dated _____, at San Francisco, California.